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14. ABSTRACT Recent analyses of Mexican drug cartels' societal control and challenge to security reveal an insurgency in the making. More dangerous is the fact that the cartels are the most successful transnational criminal organization in history. Their strength comes not only from the ability to inflict harm or deliver tons of drugs. This paper argues their greatest source of power is monetary. Analysis shows Mexican drug cartels have a mature economic model that leverages the informal economy and includes a broad base of business ownership, and depth in assets beyond drug trade. Of greater concern, the cartels have a wide span of control in banking and finance. A proper understanding of these financial networks is needed because both the United States and Mexico are failing to control the fiscal battlespace. The paper reveals Mexican laws and regulations still lack basic international standards and also highlights that banking controls in both countries are vulnerable. Finally, the paper argues renewed government and private sector partnership and investment are needed to replace the drug cartel's financial culture with a new identity that permeates the banking sector. Without fundamental cultural change and resolution of gaps in regulation, the cartel business enterprise will continue to enable security challenges on both sides of the border.				
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REFRAMING FINANCIAL SECTOR IDENTITY:
OPTIONS FOR REDUCING MEXICAN DRUG CARTEL ECONOMIC POWER

by

Mr. William Scott Cunningham

Department of Defense

A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.

The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.

15 January 2012

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Abstract

“Reframing Financial Sector Identity: Options for Reducing Mexican Drug Cartel Economic Power” Recent analyses of Mexican drug cartels’ societal control and challenge to security reveal an insurgency in the making. More dangerous is the fact that the cartels are the most successful transnational criminal organization in history. Their strength comes not only from the ability to inflict harm or deliver tons of drugs. This paper argues their greatest source of power is monetary. Analysis shows Mexican drug cartels have a mature economic model that leverages the informal economy and includes a broad base of business ownership, and depth in assets beyond drug trade. Of greater concern, the cartels have a wide span of control in banking and finance. A proper understanding of these financial networks is needed because both the U.S. and Mexico are failing to control the fiscal battlespace. The paper reveals Mexican laws and regulations still lack basic international standards and also highlights that banking controls in both countries are vulnerable. Finally, the paper argues that renewed government and private sector partnership and investment are needed to replace the drug cartel's financial culture with a new identity that permeates the banking sector. Without fundamental cultural change and resolution of gaps in regulation, the cartel business enterprise will continue to enable security challenges on both sides of the border.

The underworld has become inextricably linked to the global economy, and vice versa, through . . . the use of established banking, trade and communications networks . . . that are moving growing amounts of illicit goods and thus profiting crime.

Antonio Mario Costa, Executive Director, UN Office on Drugs and Crime

Mexican drug cartels control the largest transnational organized crime enterprise on the planet.¹ With annual revenues matching Chrysler Group or Intel, their business model is the same used by Colombian cartels twenty years ago, when the BCCI banking scandal revealed nearly \$40 million in ‘laundered’ cocaine proceeds. Colombian drug syndicates leveraged a multinational institution with offices in Panama, Miami and other cities worldwide and evidence pointed directly to corporate, military and government complicity at the highest levels. The salient change since that time is in geography and scale, with dollar values in the most recent U.S.-Mexico money laundering scandal ten-thousand times greater than the BCCI experience.² Combatant commanders and interagency planners must recognize the history and scale of this problem and should have an appreciation of the significant power available to oppose our collective efforts, as well as the corrosive power large sums of money have in areas of United States and Mexico where drug cartels operate. Cartel leaders in 2011 build economic value that is traded for political influence, fuels violence, and is reinvested in new ventures. Their businesses co-exist within Mexico’s formal and informal economy, transparent to many citizens. They have penetrated a broad range of businesses as well as the banking and finance sector, where reinvigorated corporate compliance and identity could complement ongoing security operations that employ armed force. In order to prevent cartels’ access to a significant source of power and resources, the

U.S. and Mexican governments must take more decisive and integrated action in the banking and finance sector.

Three alternate viewpoints argue that the system is coping effectively with Mexican drug cartel involvement in the business sector. First, some would argue, is that no change in government strategy is needed because U.S. Bank Secrecy Act (BSA) and Mexican Secretariat of Finance and Public Credit (SHCP) regulations are sufficient to reduce cartel access. Congressional testimony, press releases and news articles portray a matrix of agencies working in close coordination, with overlapping law enforcement and regulatory successes and cartel leader indictments that usually include money laundering on the charge sheet.³ The U.S. Department of Justice recorded its largest ever money laundering investigation in 2010, citing banking giant Wachovia with processing over \$370 billion in suspect transactions. In the area of bulk cash interdiction, programs with impressive sounding objectives and track records appear to show progress. Both DEA and Department of Homeland Security Immigration and Customs Enforcement agency (DHS/ICE) reported other busts in 2007 and 2009 where hundreds of millions in cash were seized. A second perspective is that recently announced bilateral, interagency, and information-based initiatives will soon close loopholes across the financial industry in the United States and Mexico, effectively catching those who attempt to deposit, move or extract large sums of money associated with the drug trade.⁴ For example, in 2011 Mexico enacted groundbreaking regulations to control U.S.-dollar cash transactions.⁵ According to State Department reporting and other congressional testimony, an array of new unilateral and bilateral efforts are in place, and soon regulations will be enacted on illicit use of prepaid stored-value cards.⁶ Third, it could be argued that many other business sectors, such as

transportation or agriculture have more compelling causal linkage to overall cartel operations, and should be the primary target of increased bilateral regulation and law enforcement. Press reporting from 2009 from the Mexican state of Michoacán shows the variety of companies that could be targeted, where,

Money that comes from the illegal activities of [*La Familia*] as well as other groups, such as the Valencia Cartel and ‘Los Zetas,’ . . . is mostly invested in services. These include gas stations, hotels, clothing stores, self-service stores, cellular telephone retailers, transnational franchises, night clubs, discotheques, car dealers, auto repair shops, restaurants, real estate for land, ranches, and farms, as well as financial investments. . . .⁷

Each of these issues will be addressed by demonstrating how cartel leaders, fully aware of the roadblocks set against them, take countermeasures to ensure continued success in building wealth and power. While cartels are also directly involved in criminal extortion across the Mexican economy, collecting significant financial proceeds, that practice will not be addressed in detail.

Access to Financial Resources Defines Mexico’s Power Struggle.

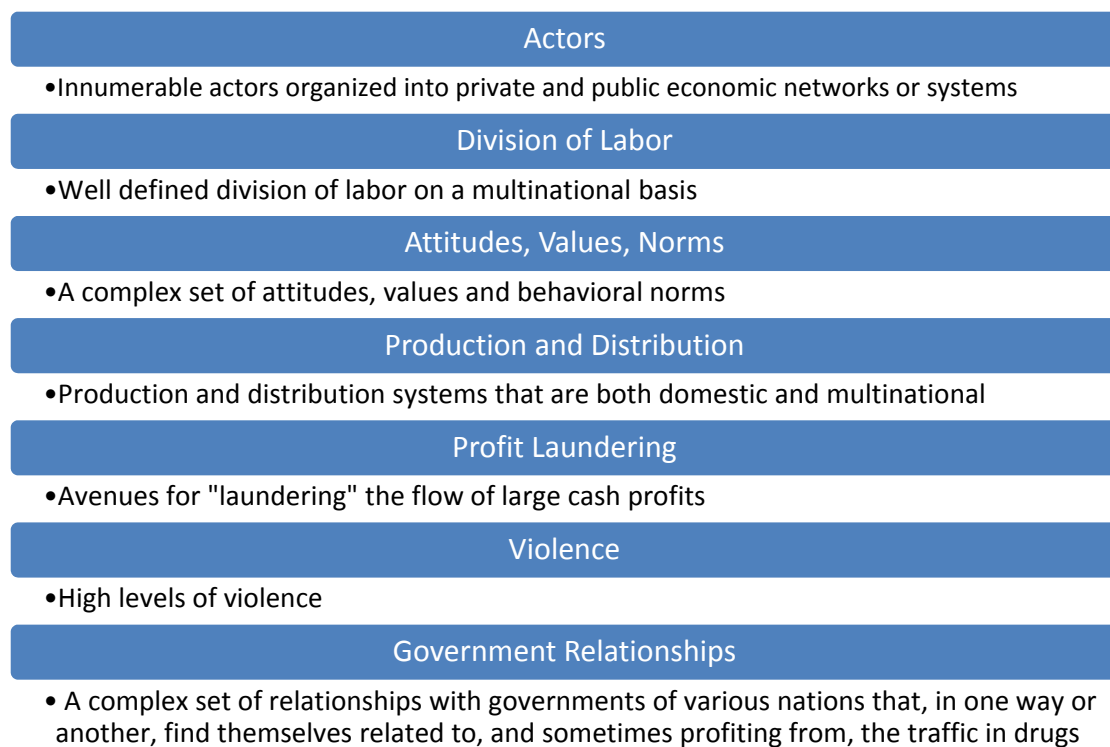
The massive capital available to Mexican drug cartels parallels their political and military power. In a 2010 New Yorker article, investigative journalist William Finnegan describes how this perception translates to average Mexican citizens: “The narcos use jets and helicopters, speedboats, and even submarines. The wealth and weaponry of the drug gangs dwarf the resources of the state.”⁸ Penetration of business and financial systems by transnational drug traffickers is a fact documented for at least 25 years, with origins before the nineteenth century. In the colonial era, drug profits were a means to an end: for the

British, exporting opium to China helped fund the cost of governing India. For the French, drug trafficking financed operations in Indochina.⁹ The illicit economy in which Mexican drug trafficking organizations (DTOs) operate is but one piece of a larger transnational criminal organization (TCO) network spanning the globe. RAND and the United Nations each use the most systematic approach in illegal drug market valuation, citing Mexican cartels' collective profit in a range of \$4.6 to 6.6 billion annually.¹⁰ (Appendix A) Mexican drug cartels receive only a portion of the total \$30-40 billion marketplace, as middlemen. The remainder is apportioned to other entities in the supply chain. Just as in a legitimate business enterprise, they recover only part of overall sales, the remainder passing to other participants in the supply chain (i.e., farmers, processors, smugglers, and street-level dealers).¹¹ (Appendix A)

The drug trafficking model, as one of several types of TCO, is well developed in literature on the subject. In 1986 expert James Mills identified seven basic components of the "underground drug trafficking empire,"¹² which aptly reflects the structure observed in the current situation in Mexico. (**Error! No bookmark name given.**Figure 1). The highest level actors succeed because they can navigate and network in the lawless underworld, deliver or withhold punishment, and manipulate normally accountable members of the government or private sector.¹³ A recent example of government corruption at a very high level is the former Quintana Roo State Governor, Mario Ernesto Villanueva Madrid, extradited to the United States in 2010. Supporting the Juarez cartel while governor from 1994 to 1999, Villanueva Madrid enabled DTOs significant freedom of movement in and around Cancun, ultimately laundering over \$19 million through his Lehman Brothers accounts in New York and elsewhere. Under his administration, 19 tons of high quality cocaine was exported to the

United States.¹⁴ The surge in violence is due to these qualities in cartel leaders, plus structural changes in three parts of Mills' model: numbers of actors, conflicts over distribution, and their relationship with the government. The nexus of legitimate business and governance with the illicit drug trade is an important focal point for government and private sector positive action because it is the point where public and private interests merge most noticeably in Mills' model.

Figure 1. Components of a Drug Trafficking Organization.



Source: James Mills cited in Mark H. Moore, *"Organized Crime as a Business Enterprise"* (1989), in John M. Martin and Anne T. Romano, eds., *Multinational Crime: Terrorism, Espionage, Drug and Arms Trafficking*, 51.

Three changes have arguably created a ripple effect across all levels of Mills' model, and across the web of Mexican DTOs. First, global economic reforms, implemented in Mexico in the 1980s and 1990s structurally changed the Mexican economy, removing

government controls to enable market-based growth. Dr. Peter Andreas, an expert in political economy at Brown University, describes how these same reforms created unintended consequences, allowing the system to “facilitate and encourage not only legal economic activity but also illegal economic activity, particularly drug production, trafficking, and money laundering.”¹⁵

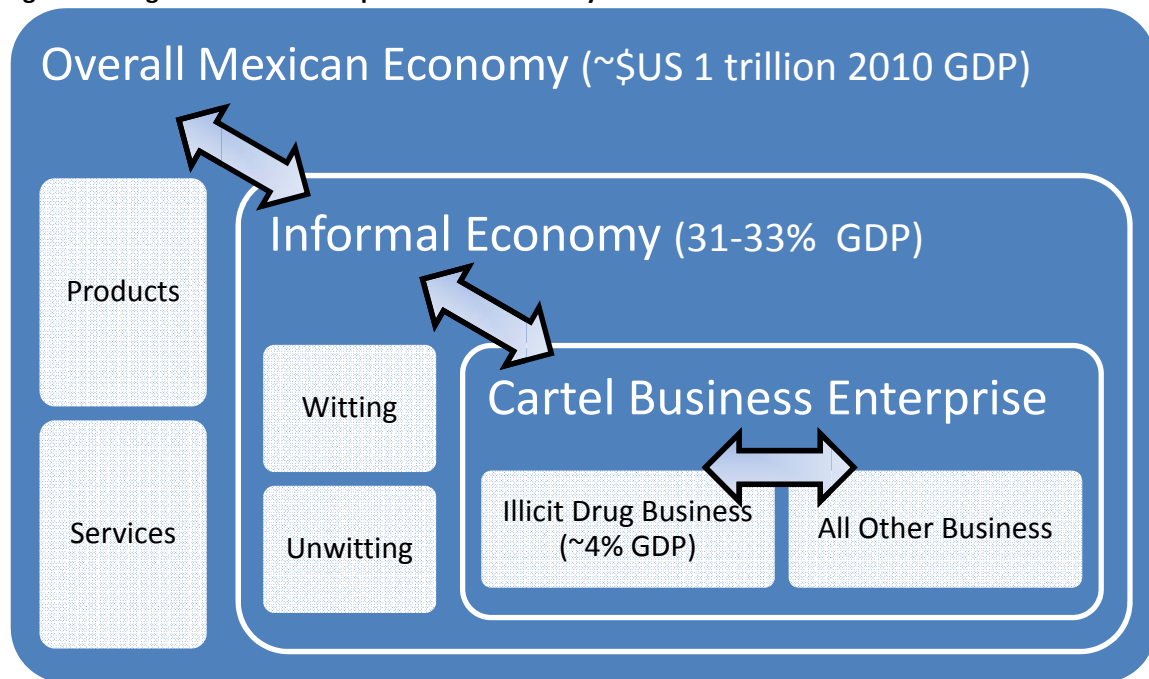
Second, in parallel with economic deregulation, the United States market for the most lucrative trade, cocaine, has contracted. Consumption, demand and value for cocaine have each dropped steadily since the mid-1990s (Appendix A). For example, according to United Nations reporting, cocaine usage rates in the United States at the 12th grade level have dropped from their peak, 1-in-7 in the 1980’s, to 1-in-20 as of 2010.¹⁶ Consumption quantities for cocaine in the United States dropped almost 40 percent, between 2000 and 2009.¹⁷

The third major change, starting when the *Partido Acción Nacional* (PAN) took power in 2000, was a fundamental shift in the Mexican government’s approach to organized crime, corruption and tolerance for an informal economy. Scholar Luis Astorga from the Institute of Social Research at the National Autonomous University of Mexico describes the cause and effect, stating:

The Mexican state [under the *Partido Revolucionario Institucional*, or PRI], served as a ‘referee of disputes’ and an apparatus that had the capacity to control, contain, and simultaneously protect these groups. As the PRI gradually lost power during the 1980s and 1990s, this system collapsed. The decline of one-party rule left the Mexican drug trade without a central governing authority¹⁸

Each of these changes, alongside a fracturing of the cartel and drug gang organizational structure has left the marketplace for both drug shipments and underlying organized crime subject to infighting and essentially a struggle for the shrinking market share. Figure 2 illustrates characteristics of Mexico's economy, highlighting the significant portion of business activity that is not regulated, taxed or otherwise under the purview of federal, state or local authorities (the "Informal Economy").¹⁹ Aside from practical issues of uncollected taxes, Mexico's informal economy provides freedom of action for cartel business, organized criminals, and street-level criminals. Arrows between each level represent banks, other financial organizations and methods such as money laundering and bulk cash smuggling.

Figure 2. Drug Cartel Relationship to Overall Economy



Source: The Author (model), and Douglas Farah, *Money Laundering and Bulk Cash Smuggling* (data)

Drug Cartels' Penetration of Mexican Business.

The DTO's non-drug business deserves particular scrutiny to understand cartel penetration of that part of the economy that both enables the drug trade and increases overall cartel economic and political power. Different aspects of the cartel business enterprise will be examined to show challenges in directly targeting the network.

The United States - Mexican economic relationship is particularly robust. That the nation is Mexico's largest trading partner creates an ideal business environment for cartels.

Northbound trade, worth over \$240 billion in goods and services in 2010, increased 30 percent from 2009.²⁰ Cartels need the economic system to be malleable in order to extract maximum political power from the illicit drug business. Author Sayaka Fukumi describes, "Drug traffickers invest in the legitimate economy because they need to 'launder' the money they have acquired . . . [DTOs] tend to have various legal 'front companies' that are owned by drug traffickers, or under the names of different persons. Wealthy drug traffickers . . . tend to possess the majority of local businesses and service industries."²¹

Figure 3. DTO Businesses in U.S. Treasury OFAC sanctions and Mexican Press Reporting 2009-2011

Row Labels	Sinaloa	La Familia	Los Zetas	Valencia	Beltran Levaya	Other Org.	Gulf
Agriculture	1	1				1	
Automotive	2	2	3	2			
Aviation	2					1	
Business	6	2	1	1	2		
Construction	1					1	
Criminal			1				1
Entertainment		2	2	1	2	1	
Farming	1						
Financial						2	
Food	1	1	1	1			
Health		2			2	1	
Hotels		1	1	1			
Manufacturing	2					1	
Real Estate	2	2	3	4		1	
Retail	1	5	4	3	2		
Shipping	1	1			2		
Sports	1						
Grand Total	21	19	16	13	10	9	1

Sources: Author, U.S. Treasury, Press²²

From 2009 to 2011 U.S. Treasury Office of Foreign Assets Control (OFAC) and Mexican press reporting indicates drug cartel involvement in 17 major business types across 7 DTOs (Figure 3). It is unclear in the data why there are no OFAC business sanctions related to Tijuana, Juarez, Colima or Oaxaca cartels, or why the group commonly cited as the most powerful, the Gulf cartel, had the least occurrence of reporting.

Using similar methodology, a review of 28 U.S. Drug Enforcement Agency press releases in a three year period reveals Sinaloa and *La Familia* also share a high proportion of indictments for money laundering. Banking and financial services are infrequently cited as standalone businesses owned by DTOs. Thus, cartels have turned inwards, integrating with the business community to enhance their power base as well as providing a means to move illicit funds back into the legitimate economy. Specific information on how much drug cartel owned companies have penetrated the economy is incomplete, but one investigative journalist indicates up to 85 percent, in the state of Michoacán.²³

Banking and Finance Overview.

While they are not owned by the Mexican drug cartels, local, national and international banking and financial institutions enable cartel success. Observing their relative freedom of movement in this sphere, one could argue drug cartels effectively own the “financial battlespace.” Methods used by the United States and Mexico to interrupt connectivity between the business sector and financial institutions include seizing property, freezing finances through the international banking system, interdicting bulk cash shipments, or designating specific companies off limits to third parties, through sanctions. Despite the fact that “Pillar One” of the Merida Initiative focuses on disrupting the operational capacity

of organized crime, including assets, this effort against cartel finance has not been effective. For a seemingly straightforward strategy, there is a remarkable lack of consistent or successful implementation in either the United States or Mexico, with recriminations and finger-pointing in both nations between and among elected officials, legislators, academics, associations, and other finance professionals and lobbyists. Research reveals a disturbing picture in Mexico, where very basic international standards for oversight are absent. The challenge faced by policymakers, regulatory agencies and law enforcement is that in a resource constrained environment, difficult choices must be made on how best to use financial intelligence and economic forensics. Targeting individual businesses connected to kingpins (the lowest level in Figure 2), while necessary, is a numbers game in which analysts and software based tracking are outnumbered by the cartels and other participants in the witting and unwitting elements of the United States and Mexican economies. This method of targeting kingpins also presumes regulatory agencies have high confidence in names and relationships of the targeted entities – commonly referred to in intelligence jargon as “known-knowns.”

U.S. government agencies vigorously recommend targeting drug cartel financial centers of gravity. Assistant Attorney General Lanny Breuer, U.S. Department of Justice Criminal Division, testified before Congress in 2009: “destroying the leadership and seizing the financial infrastructure of the [Mexican] cartels undermines their very existence.”²⁴ Assistant Secretary John Morton from DHS/ICE testified in 2009: “Drug cartels pose a dangerous threat in part due to their extensive monetary resources. The United States must

interrupt that illegal flow of money.”²⁵ Treasury Assistant Secretary for Terrorist Financing Daniel Glaser testified before Congress in 2011:

Even as sanctions remain a centerpiece of the Treasury Department’s counter narcotics strategy, we recognize the importance of drawing upon additional tools to achieve a deeper and more lasting impact. This requires developing a specific understanding of the financial infrastructure of the Mexican TCOs. More detailed information about the key accountants, bookkeepers, attorneys and others who launder money for the cartels as well as the formal and informal financial institutions they use will allow for more varied and powerful disruption.²⁶

When OFAC designates an individual or company as part of the process to remove drug kingpins’ access to finance, a robust technical data exchange and public relations campaign is initiated to ensure U.S. corporations, institutions and other regulatory agencies nationwide are notified. Companies can also review entities that have been “blacklisted” through their own processes. Treasury creates illustrated network diagrams to enhance awareness; Appendix B shows an organization listed by OFAC in 2011, the *Cifuentes Villa Crime Organization*, associated with the Sinaloa cartel. In this case, the diagram depicts over 40 related companies in six countries. The most alarming relationship in the network is the “Monedeux” family of companies depicted by a rectangular blue logo. The U.S. headquartered multinational is described as trading in prepaid stored value cards (United States and Spain), information systems analysis (Mexico), electronic payments (Colombia), and asset holding (Panama).²⁷ The significance of this fact will be discussed later in detail.

As of October 2011, OFAC has identified over 1100 individuals and business entities worldwide in its Specially Designated Narcotics Trafficking Kingpin (SDNTK) list. Not surprisingly, nearly 70 percent are located in Mexico and Colombia.²⁸ U.S. companies doing business with any of these entities risks fines up to \$10 million, but because this list is publicly available, DTOs or savvy organized criminals can then implement workarounds. In addition to financial sanctions by the U.S. Treasury, the United States has implemented programs to interdict bulk cash shipments. This cash, assessed to be the majority of cartel drug proceeds, is more easily laundered in Mexico and other countries. If drug dealers are unable to use multiple depositors to get around Bank Secrecy Act (BSA) \$10,000 reporting limits (a process known as “structuring or “smurfing”) and are concerned about being caught by what laundering experts refer to as “velocity,” they instead move large amounts of cash physically. Despite significant investment of resources, the methods currently used by U.S. and Mexican governments and the private sector are inadequate to have strategic effects against the cartels.

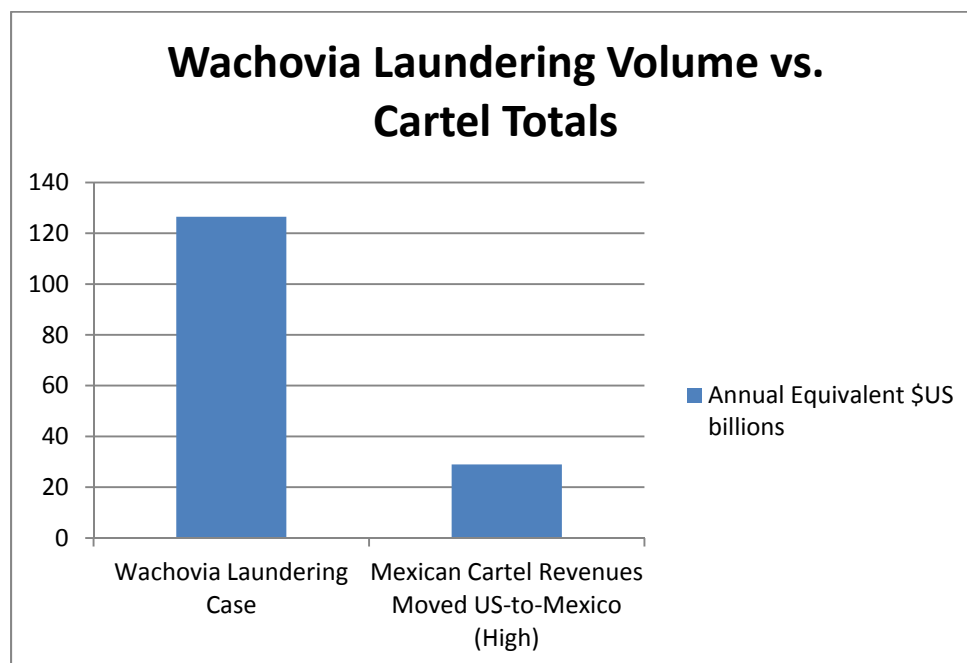
The amount of bulk cash smuggled into South America from the United States is essentially unknown, according to the Justice Department’s National Drug Intelligence Center (NDIC). According misquoted NDIC figures in GAO and DHS/ICE, \$19 to 29 billion per year in proceeds from street-level drug transactions in the United States are returned to drug kingpins and their organizations through bulk cash transshipments across the Mexican or Canadian border. This misnomer has been recycled through Congressional testimony and media, but in reality the \$18 to \$39 billion number is NDIC’s estimate of profits returned by all means including bulk cash, electronic, and all other means.²⁹ Once

U.S. currency has returned to Mexico using individual vehicles, aircraft or intermodal transport, there are a variety of ways to launder or repurpose the cash. In some instances the cash is simply moved further down the supply chain, all the way back to Colombian growers. Until recently, significant portions of the Mexican economy also operated using U.S. currency; however, in August 2010 President Calderon announced a series of money laundering reforms to prevent drug money from entering the real estate market, and to limit cash transactions for luxury goods, airplanes, boats, lottery programs, stocks, and other large purchases.³⁰ Despite these measures, the Congressional Research Service and the U.S. State Department both report that parts of the interdiction system are failing to make an impact. Analysis shows the success rate for bulk cash interdiction the 2-3% range.³¹ General Accounting Office testimony before the Senate Caucus on International Narcotics Control reveals a bulk cash interdiction system understaffed and lacking other resources needed for the mission on the U.S. side of the border.³² There is clearly a disconnect between policy assumptions on what is achievable with respect to bulk cash smuggling and the overall scale of the issue.

The most egregious case in banking history highlights the volume possible with a successful money laundering operation in Mexico and lax internal compliance in the United States. A 2010 Justice Department indictment revealed that U.S.-based Wachovia branches processed almost \$390 billion of deposits from Mexico in a 37-month period, failing in reasonable oversight that would have shown the funds were from Mexican drug cartels. The Department of Justice legal “Statement of Facts” reads like a chamber of horrors of fiscal regulations, with substantial failure of internal controls and policy at Wachovia.³³

Further analysis of the Wachovia case reveals a disconnect in cash volume not explained in any written sources. As Figure 4 highlights, either organized crime syndicates working through Wachovia had significant backlogs of cash on their balance sheet awaiting laundering (i.e., stores of cash), or a larger group of syndicates, once they realized the ploy was working, pushed any and all available “dirty” money through until Treasury stopped the process. The data shows that on an annualized basis, Wachovia laundered almost seven times the (supposed) total drug proceeds from North American sales.

Figure 4. Comparison of Annual Wachovia Money Laundering with Drug Proceeds Smuggled from United States to Mexico



Source: Author, U.S. Treasury, U.S. Department of Homeland Security

Stored value cards are a “known unknown” from a financial intelligence perspective. Similar to gift cards found at many retailers, they provide anonymity, are easily hidden, are not required to be declared to Customs and can be loaded with values as high as \$2 million.³⁴

The author easily located hundreds of these \$500 denomination Visa and American Express-branded cards at a local retail pharmacy. Over a decade ago the U.S. Department of the Treasury recognized the inherent risk of new methods for cartels to move money. Treasury expressed concern over drug smugglers' use of pre-paid cash storage cards and web-based payment methods similar to PayPal. This cyberpayment threat was new and poorly understood at the time, so RAND organized a war game using a future year scenario to show the impact of Mexican drug cartel entry into that business space.³⁵ Results of that 1998 study were followed by further intelligence analysis on the threat, but over a decade later the United States and Mexico struggle to monitor or control this type of money laundering method, much less enact viable legislation. The U.S. Treasury has so far moved much too slowly in enacting guidelines or proposing new laws, Congress is hamstrung, and the industry claims a non-problem. Yet, many drug intelligence reports on the issue of cash proceeds discuss the issue with concern.³⁶ As discussed earlier, the Treasury SNDTK sanction of a network of pre-paid stored value card companies, connected to the Sinaloa cartel, should be sufficient evidence the threat is not just theoretical (Appendix C). Following March 2011 expert testimony to a Senate panel that contrasted the clear threat of these devices against Treasury inaction, Senators demanded immediate action in a scathing letter to Treasury Secretary Timothy Geithner.³⁷ New legislation was proposed in October 2011, but for now the loopholes remain open.

Less than a month after 2010 press reporting of the Wachovia scandal, a major Mexico City newspaper exposed that money exchange houses (*casas de cambio*, the same organizations cited as complicit in the Wachovia case) were likely still fraudulently laundering drug cash. Interviews with numerous experts showed an implicit acceptance of

the practice, parsing words, equivocating and finger pointing.³⁸ Table 1 shows the layers of complexity in the myriad of organizations in Mexico engaged in financial transactions.

“SOFOMES” or *Sociedad Financiera de Objeto Múltiple*, pose a unique challenge because these unregulated finance companies may or may not be part of the formal economy.

Table 1. Non-banking Financial Entities of Interest to Mexican Government Regulators³⁹

<u>Legal – Formal Economy</u>	<u>Legal - Informal Economy</u>	<u>Illegal</u>
• Bail Bond Companies	• Currency exchange offices	• Black-Market Peso Exchange
• Brokerage Firms	• SOFOMES	• Bulk Cash Smugglers
• Cooperatives		• “Smurfs”
• Currency Centers		
• Currency Exchanges, or <i>Casas de Cambio</i>		
• Designated Non-Financial Businesses and Professions (DNFBP) ¹		
• Financial Factoring Firms		
• Insurance Agencies		
• Lending Institutions		
• Limited-Purpose Financial Associations		
• Low Cost Financial Assoc.		
• Money Wiring Firms		
• Mutual-Fund Companies		
• Retirement Fund Management Companies		
• Stock Exchange Specialists		

Source: *Culiacan Riodoce*, “Suspicious Laundering Transactions Double in Banks,” 2010.

With robust partnership in the Merida initiative and other bilateral efforts to stem the drug trade, it would be reasonable to think that, especially after the Wachovia scandal, Mexican money laundering laws would parallel those in the United States (notwithstanding that despite clear U.S. laws, Wachovia itself failed in its own internal compliance). However, as of late 2011, only 12 of 32 states in Mexico have laws on the books addressing

¹ including Real Estate Agents, precious metal/stone dealers, lawyers, notaries and accountants.

money laundering as a crime. Highlighting this fact at the September 2011 *International Conference Prevention of Money Laundering and Financing of Terrorism*, Mexico's Attorney General of the Republic, Marisela Morales Ibanez, announced a new unit in her office focused on financial analysis.⁴⁰ However, Ibanez' call for "new" laws and efforts highlight uneven national policy as compared with the Mexican Financial Intelligence Unit (UIF). The UIF, under the office of Finance Secretary Ernesto Cordero, reported investigations in late 2010 of over 25,000 "suspicious transactions" essentially related to money laundering or fraud. According to Mexican press, reporting to the Finance Secretary is legally required for "irregularities noted at officially authorized warehouses, leasing companies, and [19 other types of financial institutions]."⁴¹ A Mexico City editorial in August 2011 provides apt criticism for not placing more efforts into the legislation, instead of simply financial regulation. The numbers themselves provide a source of frustration:

Reports from this frontline struggle are disappointing. Only 25 people have been sentenced for "laundering" illegal resources even though the Financial Information Unit (UIF) of the Secretariat of Finance detected a total of 28,276,000 operations described as "relevant, unusual, and worrying." If one takes into account that the UIF's budget during those same four years was [\$15.4 million] one may conclude that the benefit-cost of this unit is very low.⁴²

President Calderon proposed new measures to limit cash transactions in August 2010, limiting the amount that can be spent on boats, airplanes and luxury goods. Financial institutions in Mexico are challenged to adapt to the new regulations due to the large increase

in entities that will require oversight (from 350 to 5,500), and further, there is skepticism from banking professionals that once irregularities are discovered the government is prepared or willing to take action.⁴³ In June, a spokesman from the Mexican National Banking and Securities Commission stated, “We would not be able to do it, the way we are designed today. We have to get reorganized to be prepared and that is going to take time. The changes will involve changes in supervision and adaptations; we need to adapt new processes and [we need] time.”⁴⁴ In his article “A Road Map for Beating Latin America’s Transnational Criminal Organizations,” author Martin Edward Andersen raises the “Palermo Model,” used first in Italy against crime syndicates by the mayor of Palermo in the 1980s.⁴⁵ He posits that just as Colombia followed Palermo’s method of replacing flawed and dangerous cultural identity with a new culture of lawfulness and human rights, so must Mexico take that path in order for armed, law enforcement measures to work. The same holds true for the business sector, where private companies, including banks and related financial institutions, must get on board and replace the greed and false sense of innocence with an identity that openly fights against the power of drug cartel money. Even if the Mexican government completely resolves issues of regulation, identity of the business sector must change.

Cooperation in Defeating Access to U.S. and Mexican Institutions.

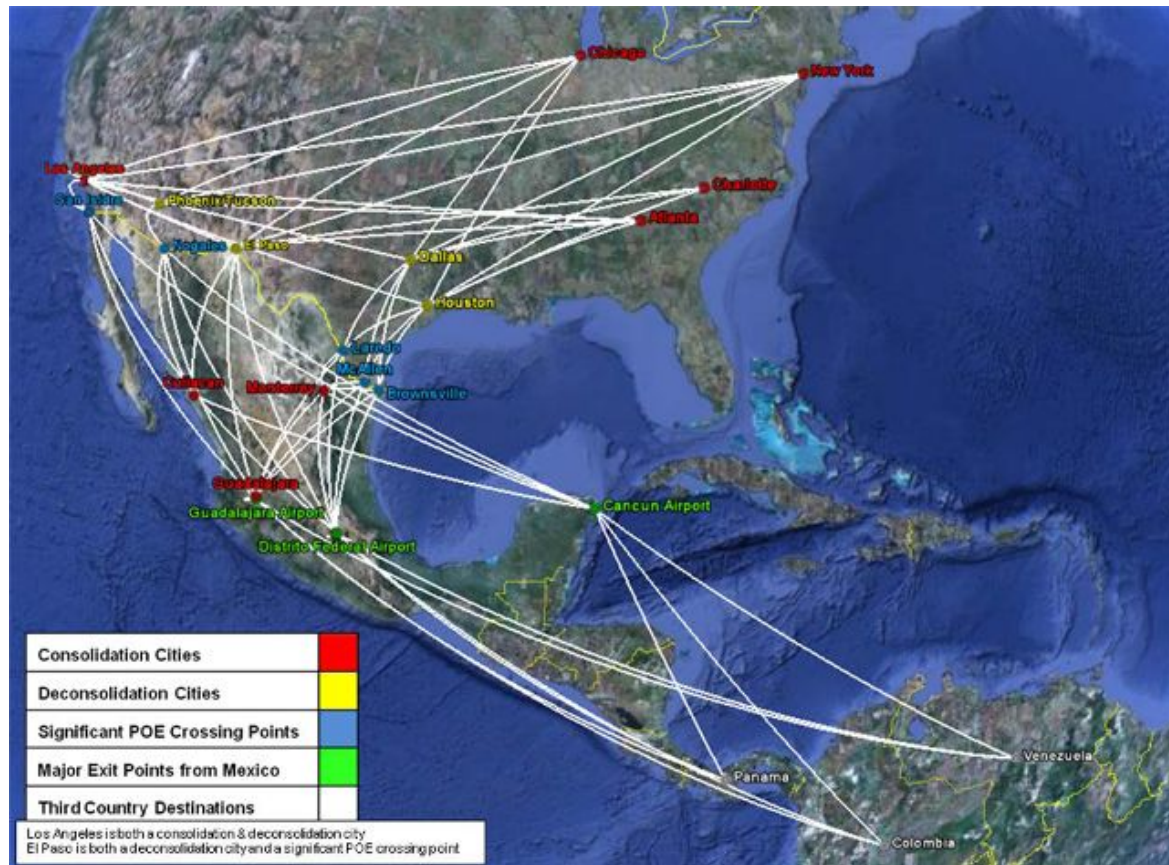
There are ample signs of cooperation between the United States and Mexico in reducing DTO access to banking and finance, including training by:

- Board of Governors of the Federal Reserve System
- FBI Academy (32 students in 2010)
- State Department International Law Enforcement Academy (ILEA)
- IRS Criminal Investigative Division (CID), 320 students in 2010

- U.S. Department of Justice Office of Overseas Prosecutorial Development, Assistance, and Training (OPDAT).⁴⁶

Appendix C lists multinational organizations that both the United States and Mexico participate in to regulate financial transactions. Despite bilateral training efforts listed in the State Department International Narcotics Control Strategy, the numbers are relatively small and not focused; much remains to be done in Mexico to effect real change. One area is in the area of capacity building, to deal with the over 34,000 suspicious transaction reports per year that must be vetted and acted upon.⁴⁷ Further, an interagency report completed in 2010 provides evidence of mixed results and significant work remaining to be effective. The U.S – Mexico Bi-National Criminal Proceeds Study was completed with liaison among eight agencies in both countries, and provides a wealth of information on processes used to move drug proceeds south (Figure 5). This report makes the unusual claim that only a quarter

Figure 5. Bulk Cash Key Movement Points and Routes



Source: U.S. Department of Homeland Security. "U.S. – Mexico Bi-national Criminal Proceeds Study." 2010.

to half of proceeds are laundered (placed into financial institutions) in Mexico, and that Mexican financial institutions are regulated (and compliant with regulations).⁴⁸ In effect the report glosses over a significant struggle over money laundering that is well reported in the Mexican press and flies in the face of the 2010 Wachovia case, where the bank processed \$4 billion of suspect Mexican bulk cash deposits as part of the overall fraud.⁴⁹

Conclusions and Recommendations.

While individual Mexican drug cartels have not merged to create a single organization, their overall financial power structure poses a significant threat to the Mexican government, and is contributing to their capabilities north of the border. They are embedded in multiple

business ventures, which will continue to be targeted with U.S. Treasury sanctions to block further damage, but the greater concern is those companies, and banking or finance relationships which remain unseen. U.S. and Mexican regulatory agencies and law enforcement must join forces to identify the “known unknowns” much earlier in their economic lifespan, so as to eliminate access by the drug cartels. It is time to reshape the way financial systems are fundamentally targeted to prevent access by the cartels and their businesses, especially where money enters the banking system. Specific recommendations include:

- Executive Branch senior leadership should apply diplomatic pressure to Mexico, to close the gap on its regulation of the entire scope of financial services and related companies, including Designated Non-Financial Businesses and Professions;
- Department of State and Department of the Treasury should encourage Mexico to enact international standards on money laundering;
- Congress and Department of the Treasury should take a more hard line approach to the threat of prepaid stored value cards, rather than waiting until significant evidence of fraud becomes apparent;
- Congress should increase Merida Initiative funding for DOJ, FBI, Treasury, IRS, and State Department, training and education programs already in place, to magnify the scope and scale of those programs;
- The Interagency team should reassess funding and capability building for bulk cash interdiction at the border;

- The highest levels of the Executive Branch should recognize that the private sector is instrumental to solving this problem; engage overtly with banks and financial sector leadership.

As the Palermo model applies to socio-cultural change, it can also be applied to the culture of business in the United States and Mexico. The most important new direction that must be taken is government leadership for renewed efforts on corporate identity across the business sphere that says *No Aqui*, or “Not Here.” Only then will the business sector begin to push back noticeably against the cartels and make headway against their drug empire.

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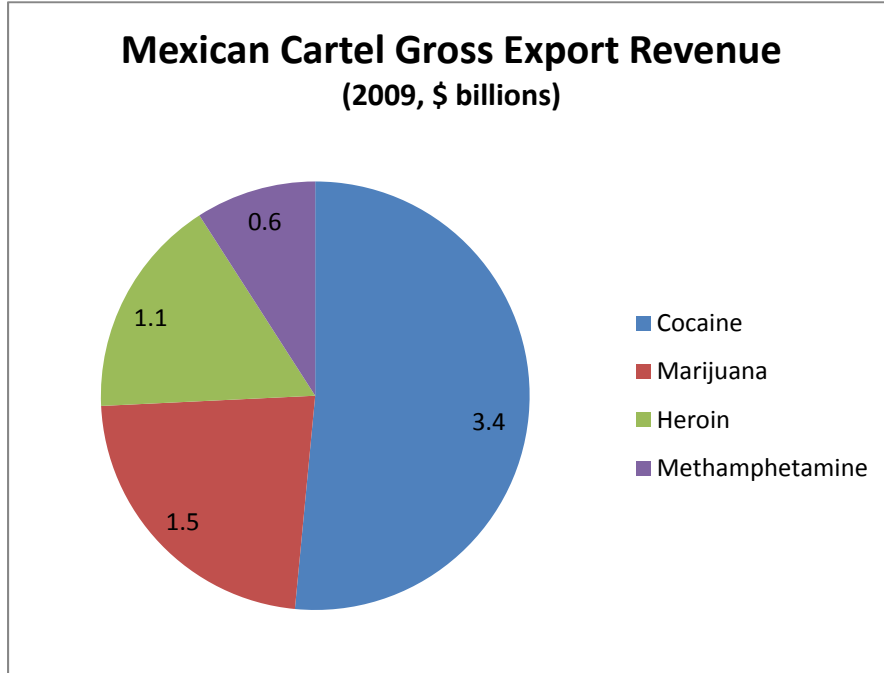
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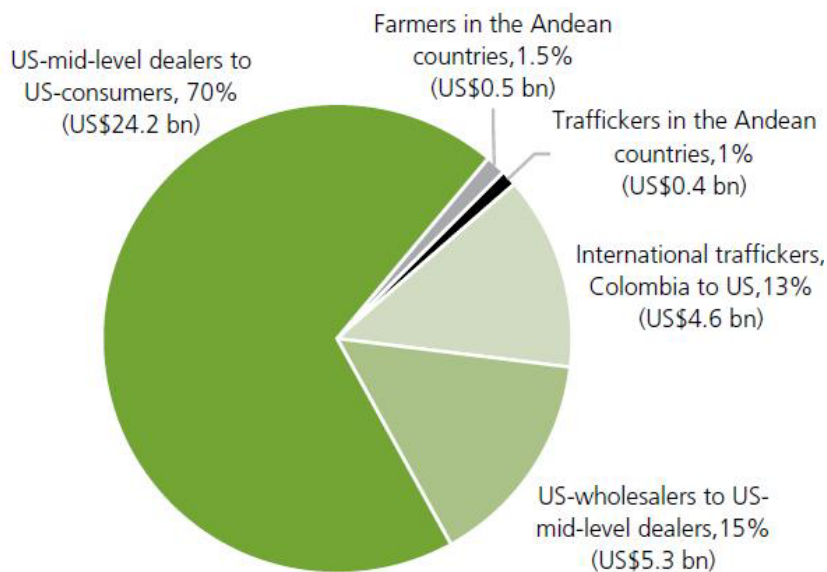
APPENDIX A: Drug Value Consumption, and Demand

Figure 6. Mexican Cartel Gross Export Revenue (\$ billions)



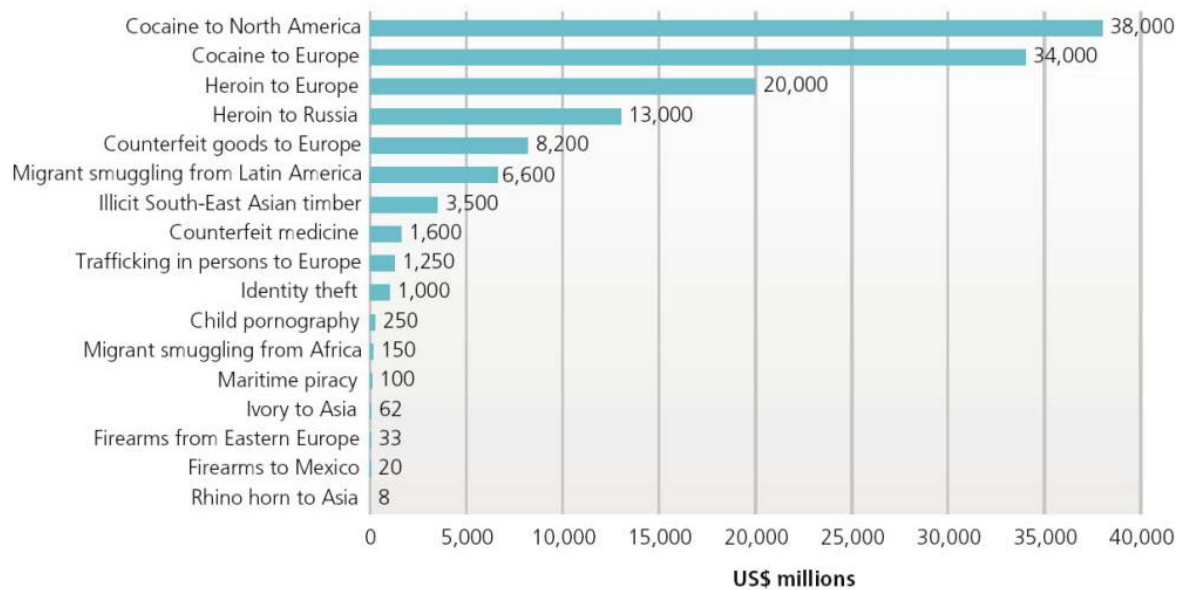
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Figure 7. Distribution of Gross Profits (in percent) of the US Cocaine Market, 2008



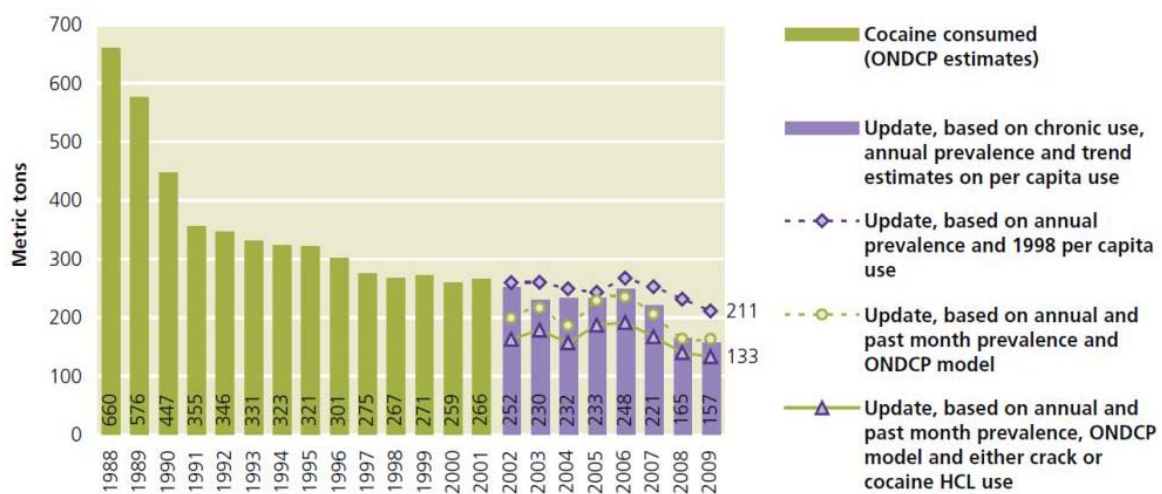
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Figure 8. Transnational Organized Crime Value Estimates. (retail US \$ millions)



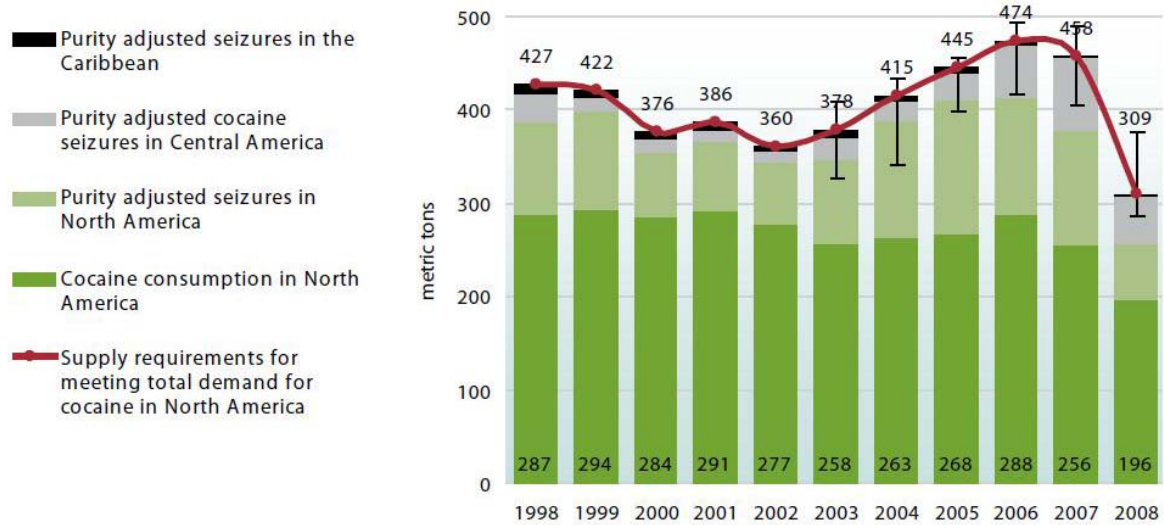
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Figure 9. Estimates of Cocaine Consumption in the United States (mt), 1988-2009



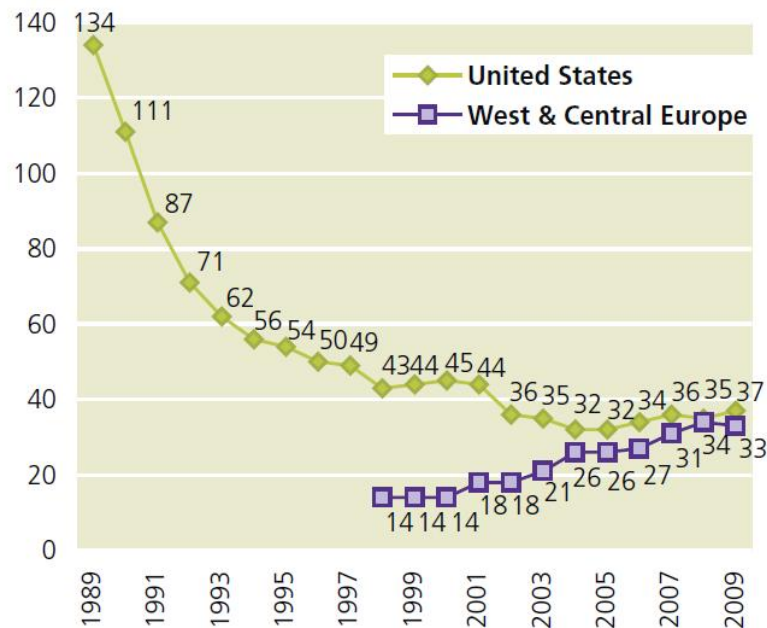
Source: UN, *World Drug Report* (New York: UN, 2011), 120.

Figure 10. Cocaine Demand (Consumption and Seizures), North America



Source: UN, *The Globalization of Crime* (New York: United Nations, 2010), 90.

Figure 11. Value of US and West/Central European Cocaine Markets,(constant 2008 US\$ billions)



Source: UN, *World Drug Report* (New York: UN, 2011), 125.

CIFUENTES VILLA Drug Trafficking Organization

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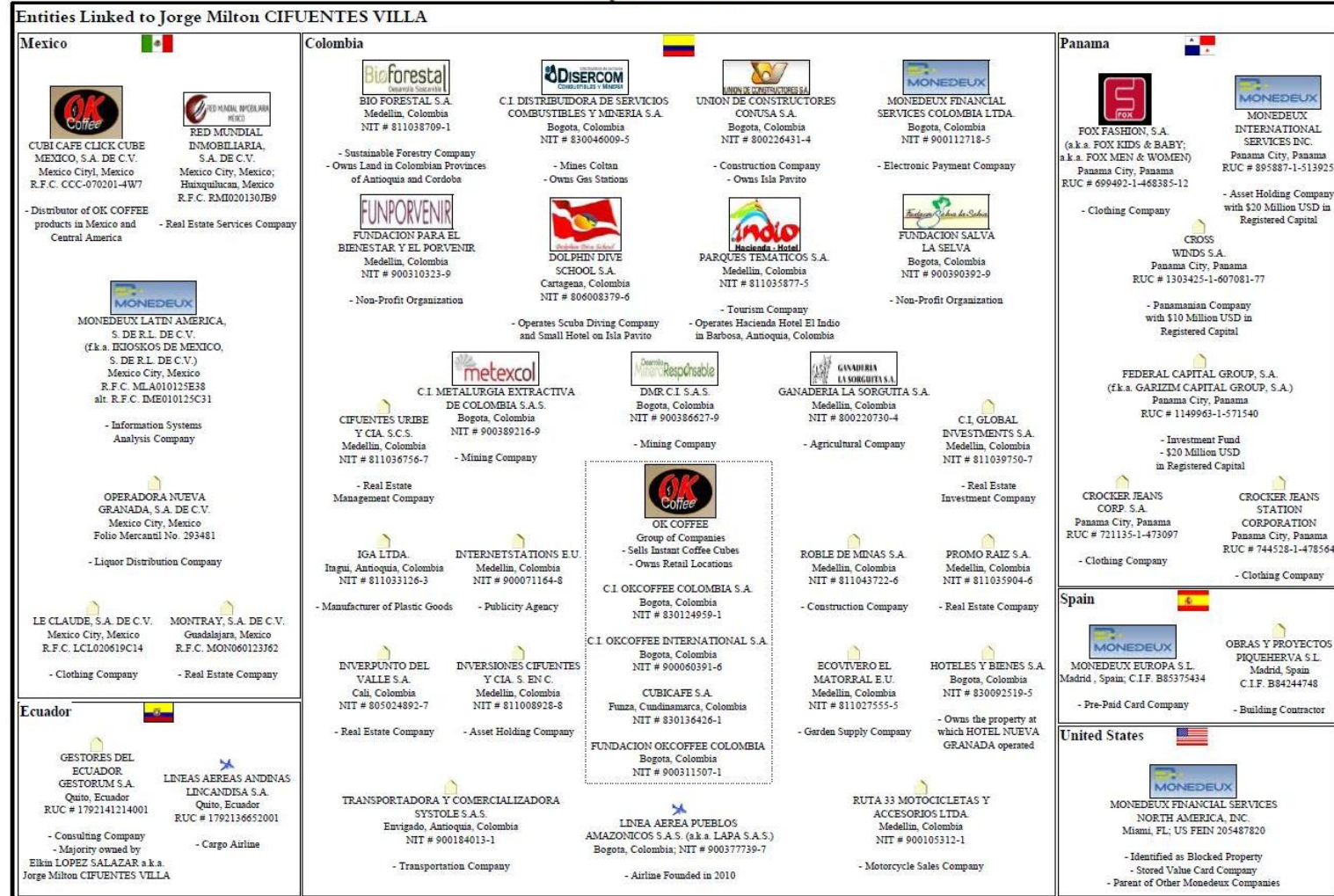


Jorge Milton CIFUENTES VILLA

U.S. Department of the Treasury
Office of Foreign Assets Control

Foreign Narcotics Kingpin Designation Act

Appendix B. Example OFAC Kingpin Business Entity Diagram



Appendix C: Multilateral Anti-Money Laundering Organizations and Programs

- The Financial Action Task Force (FATF)*
- The Asia/Pacific Group on Money Laundering (APG)
- The Caribbean Financial Action Task Force (CFATF)
- The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL)
- The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL)
- The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG)
- The Eurasian Group on Combating Money Laundering and Financing of Terrorism
- The Financial Action Task Force on Money Laundering in South America (GAFISUD)*
- Inter-Governmental Action Group against Money Laundering in West Africa (GIABA)
- The Middle East and North Africa Financial Action Task Force (MENAFATF)
- The Organization of American States Inter-American Drug Abuse Control Commission (OAS/CICAD) Group of Experts to Control Money Laundering*
- Pacific Anti-Money Laundering Program (PALP)
- United Nations Global Programme against Money Laundering, Proceeds of Crime, and the Financing of Terrorism (GPML)

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